Lim Chia Min v Cheah Sang Ngeow & Anor

FEDERAL COURT (KUALA LUMPUR) — CIVIL APPEAL NO 02-515 OF 1993
LAMIN PCA, EDGAR JOSEPH JR AND MOHD DZAIDDIN FCJJ
6 DECEMBER 1996

***Contract** — Formation — Concluded contract — Sale and puchase of businesses — Provision for formal agreement to be executed between parties — Deposit to be forfeited if agreement not finalized within certain date — Schedule and time of payment to run from date of execution of formal agreement — Other conditions of sale not expressed in detail — Whether this constituted a concluded contract*

The plaintiffs brought an action to recover from the defendant, a sum of RM500,000 being the balance of the purchase price for the sale of the plaintiffs' businesses allegedly sold to the defendant. The plaintiffs' claim against the defendant was founded on a letter dated 25 September 1990 ('AB1'), written by the defendant to them, which contained terms and conditions of the sale of their businesses to the defendant. In consequence of AB1, the plaintiffs had received from the defendant cheques totalling RM500,000, and handed over their businesses to the defendant. The plaintiffs alleged that despite demand being made, the defendant had failed to pay the balance sum of RM500,000. The defendant denied that AB1 constituted a valid contract made between the plaintiffs and him. He contended that AB1 was merely a letter expressing an intention and desire of the parties that a formal agreement would be executed between the plaintiffs as vendors of one part, and Wonson Garment Sdn Bhd ('Wonson') as purchasers of the other part, of which the defendant was at the material time a shareholder and director. In AB1, the defendant, inter alia, enclosed a cheque for RM5,000 being earnest monies and part payment for the purchase of the businesses for a total consideration of RM1m. Paragraph 2 of AB1 provided for a formal agreement to be executed between them within four weeks from the date thereof and should the agreement not be finalized by 23 October 1990, the sum of RM5,000 shall be forfeited by the plaintiff. Paragraph 3 contained eight conditions, which were referred to in AB1 as 'the main terms of this agreement'. Thus, in compliance with the terms in AB1, two formal sale and purchase agreements, AB3–12 and AB14–31, were prepared which the plaintiffs executed on 22 October 1990. These agreements were, however, not executed by Wonson. After hearing evidence and submissions of counsel, the learned trial judge gave judgment to the plaintiffs primarily on the ground that upon its true construction, his Lordship found AB1 to be the only concluded contract for the sale and purchase of the plaintiffs' businesses and therefore binding on the defendant. The primary issue in this appeal was whether, on its true construction, AB1 constituted a concluded contract between the plaintiffs and the defendant.

Held, allowing the appeal:

(1) When parties 'proposed that a formal agreement would be prepared and executed', they must mean what they say. In the instant case, para 2 clearly provided that a formal agreement was to be executed within four weeks from the date of AB1 and should the formal agreement not be finalized by 23 October 1990, the sum of RM5,000 would be forfeited to the vendors. It was quite absurd to construe AB1 as a formal agreement which would mean that under para 2, it had to be executed again within four weeks from the date in AB1 (see p 134C–D); *Von Hatzfeldt-Wildenburg v Alexander* [1912] 1 Ch 284, *Winn v Bull* [1877] 7 Ch D 29 and *Ayer Hitam Tin Dredging Malaysia Bhd v YC Chin Enterprises Sdn Bhd* [1994] 2 MLJ 754 followed.

(2) On its true construction, in particular para 2 thereof, AB1 did not constitute a legally binding contract between the parties, but merely a letter written by the defendant to the plaintiffs expressing a willingness to purchase the latter's businesses and a basis for, and subject to the preparation and execution of a formal agreement containing elaborate terms and conditions (see p 135C).

[Bahasa Malaysia summary

Plaintif-plaintif memulakan tindakan untuk mendapatkan kembali daripada defendan, jumlah sebanyak RM500,000 yang merupakan baki harga beli bagi jualan perniagaan plaintif-plaintif yang dikatakan dijual kepada defendan. Tuntutan plaintif-plaintif terhadap defendan diasaskan kepada sepucuk surat bertarikh 25 September 1990 ('AB1'), yang ditulis oleh defendan kepada mereka, yang mengandungi terma-terma dan syarat-syarat jualan perniagaan mereka kepada defendan. Berikutan daripada AB1, plaintif-plaintif telah menerima daripada defendan cek berjumlah RM500,000, dan menyerahkan perniagaan mereka kepada defendan. Plaintif-plaintif mendakwa bahawa defendan gagal untuk membayar jumlah baki sebanyak RM500,000 walaupun tuntutan telah dibuat. Defendan menafikan bahawa AB1 merupakan kontrak yang sah yang dibuat di antara plaintif-plaintif dan beliau. Beliau menegaskan bahawa AB1 hanyalah sepucuk surat menyatakan niat dan keinginan pihak-pihak bahawa perjanjian formal akan dilaksanakan di antara plaintif-plaintif sebagai penjual-penjual di satu pihak, dan Wonson Garment Sdn Bhd ('Wonson') sebagai pembeli-pembeli di satu pihak yang lain, yang mana defendan pada masa berkenaan adalah pemegang saham dan pengarah. Dalam AB1, defendan, antara lain, menyertakan cek berjumlah RM5,000 sebagai wang cengkeram dan bayaran sebahagian bagi pembelian perniagaan itu untuk balasan penuh sebanyak RM1 juta. Perenggan 2 AB1 memperuntukkan perjanjian formal akan dilaksanakan di antara mereka dalam masa empat minggu daripada tarikh itu dan sekiranya perjanjian itu tidak disempurnakan pada 23 Oktober 1990, jumlah RM5,000 akan dirampas oleh plaintif-plaintif. Perenggan 3 mengandungi lapan syarat, yang dirujuk dalam AB1 sebagai 'terma-terma utama perjanjian ini'. Oleh itu, mematuhi terma-terma AB1,

dua perjanjian jual beli formal, Ab–12 dan AB–31, disediakan di mana plaintif-plaintif melaksanakannya pada 22 Oktober 1990. Perjanjian-perjanjian ini, bagaimana pun, tidak dilaksanakan oleh Wonson. Selepas mendengar keterangan dan penghujahan peguam, hakim perbicaraan memberikan penghakiman kepada plaintif-plaintif atas alasan utamanya bahawa atas pentafsiran yang sebenarnya, Yang Arif mendapati AB1 adalah satu-satunya kontrak yang disempurnakan untuk jual beli perniagaan plaintif-plaintif dan oleh itu mengikat defendan. Isu utama dalam rayuan ini adalah sama ada, atas pentafsiran yang sebenarnya, AB1 merupakan kontrak yang disempurnakan di antara plaintif-plaintif dan defendan.

Diputuskan, membenarkan rayuan:

(1) Apabila pihak-pihak 'mencadangkan bahawa perjanjian formal akan disediakan dan dilaksanakan', mereka mesti bermaksud apa yang mereka katakan. Dalam kes sekarang, perenggan 2 dengan jelas memperuntukkan bahawa perjanjian formal akan dilaksanakan dalam masa empat minggu daripada tarikh AB1 dan sekiranya perjanjian formal tidak disempurnakan sehingga 23 Oktober 1990, jumlah RM5,000 akan dilucut hak kepada penjual-penjual. Adalah agak tidak munasabah untuk mentafsirkan AB1 sebagai perjanjian formal yang bermakna bahawa di bawah perenggan 2, ia perlu dilaksanakan sekali lagi dalam masa empat minggu daripada tarikh dalam AB1 (lihat ms 134C–D); *Von Hatzfeldt-Wildenburg v Alexander* [1912] 1 Ch 284, *Winn v Bull* [1877] 7 Ch D 29 dan *Ayer Hitam Tin Dredging Malaysia Bhd v YC Chin Enterprises Sdn Bhd* [1994] 2 MLJ 754 diikut.

(2) Atas tafsirannya yang sebenar, khasnya perenggan 2, AB1 bukan merupakan kontrak mengikat yang sah di antara pihak-pihak itu, tetapi hanyalah surat yang ditulis oleh defendan kepada plaintif-plaintif menyatakan kesanggupan untuk membeli perniagaan plaintif-plaintif dan merupakan asas kepada, dan tertakluk kepada penyediaan dan pelaksanaan perjanjian formal mengandungi penghuraian terma-terma dan syarat-syarat (lihat ms 135C).]

Notes

For cases on formation of contract, see 3 *Mallal's Digest* (4th Ed, 1994 Reissue) paras 1561–1600.

Cases referred to

Ayer Hitam Tin Dredging Malaysia Bhd v YC Chin Enterprises Sdn Bhd [1994] 2 MLJ 754 (folld)

Chinnock v Marchioness of Ely 4 DJ & S 638 (refd)

Crossley v Maycock (1874) 43 LJ Ch 379 (refd)

Esso Standard Malaya Bhd v Southern Cross Airways (M) Bhd [1972] 1 MLJ 168 (refd)

Rossiter v Miller (1877) 5 Ch D 648 (refd)
Von Hatzfeldt-Wildenburg v Alexander [1912] 1 Ch 284 (folld)
Winn v Bull (1877) 7 Ch D 29 (folld)

Legislation referred to

Income Tax Act 1967 s 83(3)

Appeal from: Civil Suit No D1–22–431–1992 consolidated with Civil Suit No D2–22–1607–1992 (High Court, Kuala Lumpur)

Chan Kok Keong (*Chan & Associates*) for the appellant.
Lee Min Choon (*Lee Min Choon & Co*) for the respondents.

Cur Adv Vult

Mohd Dzaiddin FCJ (delivering the judgment of the court): This appeal is concerned with an action brought by the respondents, who were the plaintiffs in the court below, to recover from the appellant, the defendant, a sum of RM500,000 being the balance of the purchase price for the sale of the respondents' businesses allegedly sold to the appellant. For convenience and brevity, we shall refer the appellant and the respondents as the defendant and plaintiffs respectively.

The plaintiffs' claim against the defendant is founded on a letter dated 25 September 1990 ('AB1'), written by the defendant to them, which contained terms and conditions of the sale of their businesses to the defendant. In consequence of AB1, the plaintiffs had received from the defendant cheques totalling RM500,000, and handed over their businesses to the defendant. Despite demand being made, the defendant had failed to pay the balance sum of RM500,000. The defendant denied that AB1 constituted a valid contract made between the plaintiffs and him. He contended that AB1 was merely a letter expressing an intention and desire of the parties that a formal agreement would be executed between the plaintiffs as vendors of one part, and Wonson Garment Sdn Bhd ('Wonson') as purchasers of the other part, of which the defendant was at the material time a shareholder and director. Thus, in compliance with the terms in AB1, two formal sale and purchase agreements, AB3–12 and AB14–31, were prepared by the solicitors acting on his instructions, which the plaintiffs executed on 22 October 1990.

AB1 states as follows:

25 September 1990

Mr Cheah Sang Ngeow and Madam Tai Gait Kham,

Dear Sir and Madam,

Re: Purchase of Fah Bee Sdn Bhd
Cheepy Cheep and Sykt Seng Fah

Pursuant to our discussions, I enclose herewith my cheque No SBB473460 for RM5,000 being earnest monies and part payment for the purchase of the abovenamed companies for a total consideration of RM1m.

A It is proposed that a formal agreement will be executed between us within 4 (four) weeks from the date hereof. Should this agreement not be finalized by 23 October 1990, the sum of RM5,000 shall be forfeited by you.

The main terms of this agreement are as follows:

B (1) Upon signing the agreement, a sum of RM100,000 shall be paid to you;

(2) Within 5 (five) months from date of execution of agreement (hereinafter referred to as 'the purchase date') a further sum of RM400,000 to be paid to you;

(3) Within 2 (two) years from the purchase date, the balance sum of C RM500,000;

(4) All taxes incurred, bonuses payable, sales revenues and all other expenses will be apportioned between the parties as at the purchase date;

(5) That upon execution of the agreement, your goodself and your wife shall be employed by the abovenamed companies for a duration of 3 (three) D years at a minimum salary of RM1,800 and RM1,200 respectively;

(6) That all creditors and trade debtors pertaining to transactions up to the purchase date shall be for the account of you personally and the creditors shall be settled within 1 (one) month of purchase date;

(7) That the 4 (four) trademarks 'Cheepy Cheep', 'Lambikins', 'Baby E Winks' and 'Dumbo' is included in the purchase consideration of RM1m;

(8) That the existing factory premises at Taman Mutiara shall be let to the company for a period of 3 (three) years at a rental of RM1,300 per month.

I trust you will cooperate with me in finalizing the agreement as soon F as possible.

Kindly acknowledge receipt of this letter and cheque herewith.

Your faithfully,
LIM CHIA MIN

G

Sgd: Receipt acknowledged.

At the trial, it was established that some time in July 1990, the defendant had entered into negotiations with the first plaintiff for the purchase of the plaintiffs' businesses. The plaintiffs, who are husband and wife, were sole proprietors of Syarikat Seng Fah and Cheepy Cheep Children Centre H respectively. In addition, they were the only shareholders of Fah Bee Sdn Bhd. As a result of the negotiations, AB1 was drawn up by the defendant who also paid the plaintiffs by cheque a sum of RM5,000. Subsequently, in October 1990, the plaintiffs received another cheque for RM10,000. It seemed that the first plaintiff had acknowledged receipt of RM10,000 by I executing a document to the effect that this amount was a loan from the defendant to him and in the event of the sale of the businesses materializing, the said sum of RM10,000 would form part payment of the purchase price. In the meantime, the defendant instructed the solicitors, Wiman Chew & Co, to prepare formal sale and purchase agreements, namely AB3–12 and AB14–31, which the plaintiffs duly executed on 22 October

1990 at the solicitors' office in the presence of Mr Wiman Chew. AB3–12 was an agreement for the sale of Sykt Seng Fah, while AB14–31 was for the sale of the shares of Fah Bee Sdn Bhd. These agreements were, however, not executed by Wonson. The first plaintiff, on the same day, received from Wonson two cheques for RM100,000 and RM385,000 which he and the second plaintiff had acknowledged receipt thereof. See AB13 and AB32. Both cheques had been subsequently cleared.

Findings of the High Court

After hearing evidence and submissions of counsel, the learned trial judge gave judgment to the plaintiffs primarily on the ground that upon its true construction, his Lordship found AB1 to be the only concluded contract for the sale and purchase of the plaintiffs' businesses and therefore binding on the defendant. His reasons were these. First, he found the language in AB1 was plain and unambiguous. The terms of payment were clearly stipulated. The defendant had also admitted signing AB1 where his name appeared as the purchaser. Secondly, he held that the words 'a formal agreement will be executed' by the parties in para 2 of AB1 did not constitute or make AB1 a conditional agreement. He relied on *Esso Standard Malaya Bhd v Southern Cross Airways (M) Bhd* [1972] 1 MLJ 168, which adopted the passage from the judgment of Parker J in *Von Hatzfeldt-Wildenburg v Alexander* [1912] 1 Ch 284 to the effect that it was a question of construction whether the execution of a further contract was a condition of the bargain or whether it was merely an expression of the desire of the parties as to the manner in which the transaction already agreed to would in fact go through. His Lordship was of the opinion that the reference to the proposed formal contract in AB1 merely showed a desire of the parties as to how the terms in AB1 was to be implemented.

On the two formal sale and purchase agreements, AB3–12 and AB14–31, his Lordship found that when they were drawn up, the defendant had still remained as the purchaser. He stated that if the defendant was acting for Wonson, there was no reason why all the payments could not come from Wonson. Indeed, his Lordship found no evidence that all the payments made to the plaintiffs came from Wonson. Nevertheless, he found that the only part which Wonson played was that it was unilaterally used by the defendant as a vehicle to make the purchase.

Thus, the primary issue in this appeal is whether, on its true construction, AB1 constitutes a concluded contract between the plaintiffs and the appellant. The material part of AB1 is para 2, which states:

> It is proposed that a formal agreement will be executed between us within four weeks from the date hereof. Should this agreement not be finalized by 23 October 1990, the sum of RM5,000 shall be forfeited by you.

The question here is whether para 2 is a condition or term of the bargain between the parties, making AB1 a conditional contract until the execution of a formal agreement, or is the paragraph merely an expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through? Our approach to the question will be to

A adopt first the dictum of Parker J in *Von Hatzfeldt-Wildenburg v Alexander* [1912] 1 Ch 284 at pp 288–289:

> It appears to be well settled by the authorities that if the documents or letters relied on as constituting a contract contemplate the execution of a further contract between the parties, it is a question of construction whether
B the execution of the further contract is a condition or term of the bargain or whether it is a mere expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through. In the former case there is no enforceable contract either because the condition is unfulfilled or because the law does not recognize a contract to enter into a
C contract. In the latter case there is a binding contract and reference to the more formal document may be ignored.

In *Winn v Bull* (1877) 7 Ch D 29, by a written agreement the defendant agreed with the plaintiff to take a lease of a house for a certain term at a certain rent, 'subject to the preparation and approval of a formal contract'.
D No formal or other contract was ever entered into between the parties. The defendant refused to take the lease in the present form contending that its terms were contrary to the intention of the agreement. The plaintiff thereupon brought the action claiming specific performance of the agreement. Jessel MR held that there was no contract. Relying on the judgment of Lord Westbury in *Chinnock v Marchioness of Ely* 4 DJ & S 638,
E approved by the Court of Appeal in *Rossiter v Miller* (1877) 5 Ch D 648, the learned Master of the Rolls concluded (at p 32):

> It comes, therefore, to this, that where you have a proposal or agreement made in writing expressed to be subject to a formal contract being prepared, it means what it says; it is subject to and is dependent upon a formal
F contract being prepared. When it is not expressly stated to be subject to a formal contract it becomes a question of construction, whether the parties intended that the terms agreed on should merely be put into form, or whether they should be subject to a new agreement the terms of which are not expressed in detail. The result is, that I must hold that there is no
G binding contract in this case, and there must therefore be judgment for the defendant.

In *Ayer Hitam Tin Dredging Malaysia Bhd v YC Chin Enterprises Sdn Bhd* [1994] 2 MLJ 754, the appellant ('AHTD') wrote a letter to YC Chin accepting their proposals for a project, subject to certain terms and
H conditions, one of which was that the said terms and conditions in the letter were to be constituted in an agreement and that appropriate indemnity clauses in favour of AHTD be incorporated in the agreement. Relying on the letter, YC Chin proceeded to perform some of the obligations stated therein, although no formal agreement in writing had been executed. Subsequently, AHTD instructed YC Chin to cease all work. The primary
I issue before the court was whether there was a concluded contract between AHTD and YC Chin based on the said letter. The High Court found that there was a contract and allowed YC Chin's claim.

On appeal, the (then) Supreme Court referred to several authorities on the question of arrangements made 'subject to contract' or 'subject to the preparation of a formal contract' or words to that effect. In the opinion

of the court, when such an arrangement is made, it will generally be construed to mean that the parties are still negotiating and do not intend to be bound until a formal contract is exchanged. However, having regard to the facts and circumstances of the case, the court found that the case fell within the principles enunciated in *Crossley v Maycock* (1874) 43 LJ Ch 379 that if an agreement was made subject to certain conditions, then until those conditions were accepted, there was no enforceable final agreement.

Allowing the appeal, the Supreme Court held that on its true construction, the letter did not constitute a contract binding in law but was only a record of terms which were agreed as a basis for the negotiations of a contract.

In our view, when parties 'proposed that a formal agreement would be prepared an executed', they must mean what they say. In the instant case, para 2 clearly provides that a formal agreement will be executed within four weeks from the date of AB1 and should the formal agreement not be finalized by 23 October 1990, the sum of RM5,000 would be forfeited to the vendors. It is quite absurd to construe AB1 as a formal agreement which would mean that under para 2, it has to be executed again within four weeks from the date in AB1. The events which followed after the first plaintiff received AB1 and the cheque of RM5,000 from the defendant seem to us to be consistent with the intention of the parties. First, the instruction to the solicitors to prepare the formal sale and purchase agreements, AB3–12 and AB14–31, which contained elaborate terms and conditions of the sale. This was followed by the execution of the said agreements by both plaintiffs at the solicitors' office on 22 October 1990, and the receipt of two cheques for a total sum of RM485,000. It should be remembered that under para 2 of AB1 the formal agreement must be finalized by 23 October 1990, otherwise the sum of RM5,000 would be forfeited by the plaintiffs. From the evidence, it is clear to us that the terms in AB1 were never performed and the parties proceeded to complete the sale on the basis of the terms and conditions of the formal agreements AB3–12 and AB14–31.

Paragraph 2 should also be considered in the light of para 3 which contains, what purports to be, 'the main terms of this agreement'. In our view, the words 'this agreement' cannot mean AB1, but must refer to the proposed formal agreement as envisaged in para 2. It is noted that there are eight conditions in para 3, which have not been expressed in greater detail. A prudent buyer of a medium-size business which business he has agreed to purchase for RM1m will surely want a more elaborate sale and purchase agreement containing specific clauses, such as, the firm's assets and liabilities, vendor's undertakings and warranties, appropriate indemnity clauses, etc. None of the above-mentioned clauses were, however, stipulated in para 3.

Next, conditions (1), (2) and (3) of para 3 refer to the purchase consideration, which stipulate the schedule and time of payment of the purchase price to be calculated from the date of the execution of the agreement. In our view, time cannot run from the date of the signing of AB1 because it cannot be the intention of the parties, nor will it be

A reasonable for the defendant who had paid RM5,000 as earnest money and part payment, which will be forfeited if the formal agreement is not finalized by 23 October 1990, to agree that at the same time (upon signing of AB1) he must also pay RM100,000 under condition (1) of para 3 of AB1. The inference must be that payments will be made at the stipulated B period of time which runs from the date of the execution of the formal agreement.

Having regard to what we have stated above, our answer to the primary issue in this appeal is that, on its true construction, in particular para 2 thereof, AB1 does not constitute a legally binding contract between the parties, but merely a letter written by the defendant to the plaintiffs C expressing a willingness to purchase the latter's businesses and a basis for, and subject to, the preparation and execution of a formal agreement containing elaborate terms and conditions.

Our answer to the above primary question of law is sufficient to dispose of this appeal. However, in view of the finding of the learned trial D judge that Wonson was 'used' by the defendant as a vehicle to make the purchase on his behalf and therefore the company was not the actual purchaser of the plaintiffs' businesses, we feel the short answer is this. Upon considering the contemporaneous documents in the 'Rekod Rayuan', with respect, we disagree with his Lordship's conclusion that Wonson was E not the actual buyer. First, there was an admission by the first plaintiff that he received two cheques of a substantial sum for RM385,000 and RM100,000 after both plaintiffs hnd executed AB3–12 and AB14–31. These cheques belonged to Wonson and AB13 and AB32 are plaintiffs' acknowledgment of the receipt of the money from Wonson and not from the defendant. Secondly, the list of employees in the schedule under EPF F contributions dated 24 July 1991 filed by the employers shows both plaintiffs were employees of Wonson. There is also the notification by Wonson to the Director-General of Inland Revenue under s 83(3) of the Income Tax Act 1967 stating that the first and second plaintiffs were employed by Wonson as manager and supervisor respectively. See Rekod G Rayuan 3 — pp 738 and 740. Thirdly, by a letter dated 17 July 1991, the first plaintiff informed Wonson that he had executed Form MV3 to transfer the ownership of the firms' three vehicles to Wonson. See Rekod Rayuan 2 — pp 197–201. Clearly, these documents point only to one conclusion, which is, that upon signing the agreements, AB3–12 and AB14–31, and after receiving the sum of RM500,000, the plaintiffs handed over the H management and control of their businesses to Wonson and also became the latter's employees. It follows that Wonson was the real purchaser of the plaintiffs' businesses under AB3–12 and AB14–31, despite the non-signing of the agreements by Wonson.

For the above reasons, we allow this appeal and set aside the judgment I of the court below. Costs here and below to the defendant. The deposit is to be refunded to the defendant.

Appeal allowed.

Reported by Loo Lai Mee